TABLE OF CASES.

Page

Brewster v. Gage, 280 U. S. 327 12
Commissioner v. S. A. Woods Machine Co., 57 F. (2d) 635 ..... 3, 14, 17
Copper Queen Consolidated Mining Co. v. Arizona, 206 U. S. 474 12
E. R. Squibb & Sons v. Helvering, 98 F. (2d) 69..... 6, 13
Eisner v. Macomber, 252 U. S. 189..... 5, 9, 19-20
Fawcus Machine Co. v. United States, 282 U. S. 375. 6, 12-13
Johnson, J. H., et al. v. Commissioner, 19 B. T. A. 840 aff'd 56 F. (2d) 58; certiorari denied 286 U. S. 551 5
Lucas v. Alexander, 279 U. S. 573 9
Luckenbach Steamship Co. v. United States, 280 U. S. 173 11
Massachusetts Mutual Life Insurance Co. v. United States, 288 U. S. 269 ..... 12, 13
McCaughn v. Hershey Chocolate Co., 283 U. S. 488.... 12
Murphy Oil Co. v. Burnet, 287 U. S. 299..... 12
National Lead Co. v. United States, 252 U. S. 140..... 11
Old Colony R. Co. v. Commissioner, 284 U. S. 552..... 12
Pan-American Bank & Trust Co. v. Commissioner, 5 B. T. A. 839 18
Reinecke v. Northern Trust Co., 278 U. S. 339..... 9
United States v. Alabama Great Southern R. Co., 142 U. S. 615 11
United States v. Cerecedo Hermanos y Compania, 209 U. S. 337 12
United States v. Jackson, 280 U. S. 183 ..... 6, 12
United States v. Kirby Lumber Co., 284 U. S. 1, 2, 4, 6, 8, 19, 20
Universal Battery Co. v. United States, 281 U. S. 580.. 12

TREASURY REGULATIONS AND RULINGS.

G. C. M. 12955, XIII-1 C. B. 107 17
Regulations 77, Art. 66 ..... 2-3, 4, 10
Regulations 77, Art. 66, as amended by T. D. 4430, XIII-1 C. B. 36 10-11
Regulations 77, Art. 176 10
T. D. 4430, XIII-1 C. B. 36 ..... 3, 10-11, 17

IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

No. 385.

FIRST CHROLD CORPORATION, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR PETITIONER.

Opinion Below.

The opinion of the Board of Tax Appeals (R. 16) is unreported. The opinion of the Circuit Court of Appeals (R. 33) is reported in 97 F. (2d) 22.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on May 26, 1938 (R. 36). Thereafter, and on June 24, 1938, petitioner filed a petition for rehearing with the Circuit Court, which was denied on June 28, 1938 (R. 47). The petition for a writ of certiorari was filed September 27, 1938, and was granted November 7, 1938, and the case

sons. *United States* v. *Jackson*, 280 U. S. 183, 193, 196; *Fawcus Machine Company* v. *United States*, 282 U. S. 375, 378; *E. R. Squibb & Sons* v. *Helvering*, (C. C. A. 2d) 98 F. (2d) 69, 70; and other cases.

Whatever force a change in applicable regulations may have prospectively, such provision should not be applied retroactively.

III. The rule that a corporation realizes gain or loss in buying and selling its own stock is limited to those cases where the corporation is dealing in its own stock in the same manner as if it were dealing in the shares of another corporation either for speculative purposes or for investment. Clearly the facts in this case show that the petitioner was not dealing in its own stock. It did not speculate in its stock, nor did it buy for investment, nor was the stock so carried on petitioner's books. The stock which it acquired was carried in a separate account on the liability side. Stocks of other corporations which the petitioner acquired were carried under separate accounts on the asset side.

IV. If the petitioner is to be charged with gain in buying and selling its capital stock, then gain or loss was realized when the stock was repurchased and not when an equal number of shares were later sold. *United States* v. *Kirby Lumber Company*, 284 U. S. 1. As an illustration, if a corporation repurchases at $90 shares which were sold previously at $100, clearly the corporation "has realized within the year an accession to income." *United States* v. *Kirby Lumber Company, supra.* No stock having been repurchased in 1933 (the year involved herein), no gain occurred in that year.

V. If respondent's contentions in the court below were to be adopted, absurd results would follow.

Argument.

POINT I.

THE SALE OF TREASURY STOCK IS A CAPITAL TRANSACTION UPON WHICH GAIN OR LOSS IS NOT RECOGNIZABLE FOR TAX PURPOSES.

When the petitioner purchased the shares of its own stock they were charged to an account designated "Treasury Stock" in the amount paid therefor, and they were carried as such on the liability side as a deduction from issued capital. They were not regarded as an investment and were not carried in the accounts along with other securities (R. 20). This is similar to a partial liquidation. If an acquisition of shares is pro rata from all its stockholders, it is clear that the only result is that the corporation has distributed a part of its assets to its stockholders as a distribution in partial liquidation. It is no less clear that a distribution has taken place when the stock is acquired otherwise than pro rata from stockholders. When a corporation acquires its own stock, it has not purchased an asset—it has satisfied a liability; a capital rather than a debt liability, it is true, yet in the strictest sense of the word a liability. A share of stock is representative of an ownership interest in the corporation itself. When stock is reacquired by the corporation, the stock does not take the place of the assets distributed. In fact the corporation has less than it had before. True, each share of stock still outstanding represents a greater proportionate interest in the remaining assets, but this is because the capital liability of the corporation has been satisfied in part and the ownership interest of the stockholders in the assets has shifted.

When treasury stock is retired and new shares are issued, the corporation acquires new capital and assumes an additional capital liability. The liability is the obligation of the corporation, through its officers and directors, to account to its stockholders for its use of the assets in accordance with the law and its charter. From the standpoint

of the corporation it is a purchase rather than a sale. And the purchase is accomplished not by an exchange of assets, but by the creation of a capital liability, because in no real sense was the treasury stock an asset or a liability.

Stock reacquired by the issuing corporation may be either retired or allowed to remain in the treasury. In the latter event it is not an asset any more than a bond is an asset of the obligor. Its only value is a potential one, determined upon reissue by the real assets of the corporation. Authorized but unissued stock has the same character of exchangeable value, yet it would not be called an asset. Surely no further argument is necessary to sustain the proposition that treasury stock is not an asset. On the other hand, if it is a liability, its repurchase falls within the *Kirby Lumber* case, *supra*.

The pertinent regulation is clear to the effect that neither gain nor loss is incurred upon the original issue of stock. If acquired stock is retired but subsequently an equal number of shares of stock is sold at a price greater than the cost of the stock retired, the substitution results in an accretion of assets to the corporation which would not be considered taxable income. Assuming the newly issued shares were equal in number to the shares retired, the capital liability of the corporation would remain the same, surplus would be increased and yet there would be no realization of income under the regulation.

Treasury stock does not differ from authorized and unissued stock. It does not carry voting power and it has no dividend rights. It cannot represent any interest in the corporation or in the assets of the corporation. Both the New York Stock Exchange and the Securities & Exchange Commission recognize this when they prohibit a corporation from carrying treasury stock as an asset.

In short, when a corporation sells its treasury stock it is deriving capital and not deriving a profit from capital. It is doubtful whether it would be within the power of Congress to levy an income tax upon a corporation in the sale

of its treasury stock because, in *Eisner* v. *Macomber*, 252 U. S. 189, at page 207, income is defined as—

> "'* * * the gain derived from capital, from labor, or from both combined,' * * *";

also at page 207 the Supreme Court stated:

> "Brief as it is, it indicates the characteristic and distinguishing attribute of income essential for a correct solution of the present controversy. The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain', which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived,—*'derived-from-capital;'—'the gain-derived-from-capital,'* etc."

In other words, capital derived is not taxable as income, it is the gain derived from capital that is taxable. Consequently, when a corporation sells its treasury stock, it is doing nothing more than deriving additional capital.

The construction sought by the respondent in support of the proposed assessment would probably lead to an unconstitutional levy upon capital. Such a construction should be avoided. *Lucas* v. *Alexander*, 279 U. S. 573, 577-8; *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339, 348-9.

POINT II.

During the Taxable Year Here in Question and for a Long Period Prior Thereto the Regulations of the Treasury Department Specifically Ruled That a Corporation Had No Gain or Loss in Buying and Selling Its Own Stock, Founding the Ruling on the Principle That the Transactions Involved Were Capital in Nature.

All the revenue laws, beginning with that of 1909, are completely silent on the question whether a corporation realizes gain or loss in buying and selling its own stock.

However, until amended on May 2, 1934, the respective regulations have consistently specifically provided that gain or loss was not to be recognized from such transactions. For instance, Regulations 77, interpreting the Revenue Act of 1932, and promulgated on February 10, 1933, provide in Article 176 in part as follows:

> "A corporation sustains no deductible loss from the sale of its capital stock. (See article 66.)"

Article 66 of said Regulations, set out in full at pages 2-3 herein, provides in part:

> "* * * or if the corporation purchases any of its stock and holds it as treasury stock, the sale of such stock will be considered a capital transaction and the proceeds of such sale will be treated as capital and will not constitute income of the corporation. A corporation realizes no gain or loss from the purchase or sale of its own stock."

It was not until after the taxable year here involved that the Commissioner changed his regulations so as to provide that *in certain instances* a corporation would realize gain or loss upon the sale of its own stock, the rule providing that if a corporation "deals* in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another." This change was made by T. D. 4430, XIII-1 C. B. 36, which was promulgated on May 2, 1934, and which amended Article 66 of Regulations 77 to read as follows:

> "*Acquisition or disposition by a corporation of its own capital stock.*—Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The

*We point out hereinafter, pages 14-18, that the petitioner was not dealing in the shares of its own capital stock.

receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"But where a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of applicable statutes."

Whatever force the foregoing regulations may have prospectively, they should not be applied retroactively. Certainly a return properly filed under the regulations as they existed at the time it was filed ought not to be disturbed except for very cogent reasons.

We maintain that where the regulations of the Commissioner, promulgated with the approval of the Secretary of the Treasury, provide that gain or loss is not to be recognized by a corporation in buying and selling its own stock, on the principle that the transaction is capital in nature, they should not be disturbed where repeatedly reenacted by Congress. The rule of construction is that where statutes are reenacted after long continued interpretation, such reenactment amounts to an adoption by Congress of such construction.

National Lead Company v. *United States*, 252 U. S. 140;

United States v. *Alabama Great Southern R. Co.*, 142 U. S. 615;

Luckenbach Steamship Co. v. *United States*, 280 U. S. 173;

Copper Queen Consolidated Mining Co. v. *Arizona*, 206 U. S. 474;
United States v. *Cerecedo Hermanos y Compania*, 209 U. S. 337;
United States v. *Jackson*, 280 U. S. 183;
Brewster v. *Gage*, 280 U. S. 327;
Universal Battery Co. v. *United States*, 281 U. S. 580, 583;
Fawcus Machine Co. v. *United States*, 282 U. S. 375;
McCaughn v. *Hershey Chocolate Company*, 283 U. S. 488, 492-3;
Massachusetts Mutual Life Insurance Co. v. *United States*, 288 U. S. 269;
Murphy Oil Co. v. *Burnet*, 287 U. S. 299;
Old Colony R. Co. v. *Commissioner*, 284 U. S. 552.

In *United States* v. *Jackson, supra*, Mr. Chief Justice Taft stated the rule clearly (p. 193):

> "It is a familiar rule of statutory construction that great weight is properly to be given to the construction consistently given to a statute by the Executive Department charged with its administration (citing cases); and such construction is not to be overturned unless clearly wrong, or unless a different construction is plainly required * * *."

In *Universal Battery Company* v. *United States, supra*, the Supreme Court stated (p. 583):

> "This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years and it ought not to be disturbed now unless it be plainly wrong."

In *Fawcus Machine Company* v. *United States, supra*, Mr. Justice Roberts said (p. 378):

> "The regulations were made pursuant to express authority (see Sec. 1309 of the Revenue Act of 1918). They are valid unless unreasonable or inconsistent with the statute. (Citing cases.) They constitute contemporaneous construction by those charged with the

> administration of the act, are for that reason entitled to respectful consideration, and will not be overruled except for weighty reasons."

In *Massachusetts Mutual Life Insurance Company* v. *United States, supra,* Mr. Justice Roberts also said (p. 273):

> "If the legislative body had considered the Treasury interpretation erroneous it would have amended the section. Its failure so to do requires the conclusion that the regulation was not inconsistent with the intent of the statute (citing cases) * * *."

The rule enunciated by the Supreme Court in the cases above referred to was recently applied by the Second Circuit Court of Appeals in a situation similar to that in the instant case and involving the same regulations. See *E. R. Squibb & Sons* v. *Helvering,* 98 F. (2d) 69, in which Judge Learned Hand says, at page 70:

> "We share the taxpayer's doubts whether it dealt 'in its own shares as it might in the shares of another corporation', within the very equivocal language of the regulation. It is at least arguable that this means to cover only speculations of a corporation, and not a profit-sharing enterprise like that at bar. But in any event it seems to us that the uniform interpretation, so long placed upon § 22(a), 26 U. S. C. A. § 22(a), by the regulation and confirmed by the inaction of Congress, was imbedded in the statute so deep that only legislation could dislodge it."

In view of the long continued practice of the Treasury Department in officially ruling that a corporation realizes no gain or loss in buying and selling its stock, there is now no basis in law for the Commissioner to claim, or for the Board to decide, that the amended regulations, promulgated after the return here in question had been filed, should be applied retroactively. The repeated reenactments by Congress, without change, of the various revenue acts, disclose a Congressional intent not to regard a corporation as real-

izing gain or loss upon buying and later selling its own stock, and whatever force the regulation as amended on May 2, 1934, may have prospectively, it is not to be applied to transactions completed prior to that date. Moreover, since the petitioner herein was not dealing in its own stock, but bought and sold its stock in order to carry out its promise to its stockholders, who contributed capital in the first instance, it is doubtful, as we point out on pages 8-9 herein, whether it would be within the power of Congress to levy a tax in such situation, even if it undertook to do so.

POINT III.

The Petitioner Was Not Dealing in Its Own Capital Stock.

As was said in *Commissioner* v. *S. A. Woods Machine Company*, 57 F. (2d) 635, by the First Circuit Court of Appeals (p. 636):

> "Whether the acquisition or sale by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction involved."

The record in the case at bar shows that during 1931 and 1932 the petitioner, pursuant to its promise to its stockholders to take the stock off their hands in the event they so desired (R. 17), purchased 2,326 shares of its own stock (R. 18). These purchases were made in a declining market. In the next year when the market conditions were better the petitioner sold 662 shares and made no purchases (R. 19). These isolated transactions are not sufficient to support a holding that the petitioner was dealing in its own stock, for it never really wanted to buy its own stock. All the petitioner did was to carry out its original promise to buy the stock back from the stockholders in the event such stockholders wanted to dispose of their interest in the corporation.

The purchases and sales made were at one point from the liquidating value. This, as the Board found, was to take care of inaccuracies (R. 20). In so doing the petitioner not only was not dealing in its own stock, but even if it were, contrary to our contention, no taxable gain in fact resulted. What occurred when the stock was sold was that new subscribers were permitted to come into the corporation on exactly the same basis as the old subscribers had at the time. It was like an existing partnership taking in a new partner on the basis of current worth. Surely one would not say that the old partners had realized income in such a situation, if the money contributed by the new member remained in the venture.

Take the case where subscribers have paid in to the corporation $100,000 for 1,000 shares at $100, which was used to buy listed securities. If those securities decrease in value to $90,000 the corporation's stock should sell at $90. Or if the market should go the other way and the securities become worth $125,000, the corporation's stock should sell at $125.00. If it sold a share for $125.00 the corporation, while $125.00 better off than before, is so because of a capital transaction. To argue the contrary is to close one's eyes to the theory of corporate taxation, viz., to tax the corporation on the profit from the sale of corporate assets and regard the sale of the corporate stock as the capital transaction which brings into being or continues in existence the separate corporate entity.

When a corporation sells a share of stock, it thereby receives into its assets the price of the stock, and gives to the purchaser a certificate evidencing his right to participate in the management of the company, to receive a pro rata share of its profits, and upon liquidation a pro rata distribution of its assets. These are proprietorship transactions, as distinguished from profit and loss transactions. If a company has been prosperous and its assets have increased in value, it may sell shares at a premium—each share's participating rights being of greater value than the

original par or issuing price. But it has never been suggested that such amount of the selling price as exceeds par is income or profit, nor that it is anything but capital paid in to the corporation as a part of the consideration for the stockholder's participating rights.

Where stock is bought back after issuance, and held as treasury stock, it ceases to have participating rights of any kind. By its withdrawal from the public, the price paid for it is taken out of the corporation's assets, but the remaining shares outstanding then participate in larger pro rata fractions in the assets remaining. So far as the corporation is concerned, no gain or loss is realized for tax purposes, in such a transaction; if the share is repurchased for less than its issuing price, the difference represents capital paid in and abandoned by the shareholder; if for more than its issuing price, the difference represents a reduction of capital.

Even admitting, which we do not, that a corporation which deals in its own stock as it would in that of another company, realizes taxable income or suffers deductible loss from such dealing, petitioner here contends it was not *dealing* in its own stock in any sense.

In order to sell its stock originally, petitioner promised to the subscribers—there were only some 60 or 70 of them, and all friends of the manager—that the corporation would repurchase the stock if they wished to sell (R. 17). The stock of petitioner was not listed on any exchange (R. 17). In accordance with its promise, petitioner did, in 19 instances during 1931, repurchase stock, and did so in 5 instances in 1932. In 1931 it sold only 210 shares, in lots ranging from 10 to 90 shares, in 5 different sales; in 1932 it sold one lot of 10 shares and one lot of 200 shares (R. 18). These figures indicate there was little market for the stock in those years, and considerable demand for repurchase by those who had previously bought stock. In 1933, with a general business uplift, the company was able to sell 662 shares; it bought none in that year (R. 19).

G. C. M. 12955, XIII-1 C. B. 107, is predicated on *T. D. 4430*, XIII-1 C. B. 36. Its headnote reads:

> "The gain derived by the M Corporation from dealing in its own stock for the purpose of profit in the ordinary course of business is subject to Federal income tax."

This memorandum presents facts almost directly opposite to those of the instant case. We quote from the G. C. M.:

> "The balance sheets of the M Corporation show that a substantial part of its surplus was, during the year involved, employed in trafficking in its own stock. For several years the taxpayer had been engaged in such transactions. Its income tax return for the year 1929 reflects a profit from dealing in its own stock of 50x dollars. On the books and records of the corporation the purchases and sales of its own stock were treated in the same manner as other security investments. All the purchases and sales in question were made on the open market and were recorded in the investment account of the corporation. Gains and losses on such transactions were duly reflected in its profit and loss account and in its surplus account. * * *"

No substantial part of petitioner's surplus was employed in trafficking in its own stock; it did not deal in its own stock as it would in that of another company; it did not treat the treasury stock as an investment; it did not buy the stock in the open market, but bought only as its personally-known stockholders wished to withdraw, its main object being to afford those stockholders who found it necessary to liquidate their shares a means of doing so by turning them over to the corporation.

The petitioner did not acquire its capital stock in exchange for assets sold, or in payment of liabilities due it, as was the situation in the *S. A. Woods Machine Company* case, *supra;* petitioner did not issue its shares nd treat the proceeds as an item of income; these were capital transactions and were so treated; if they resulted in a gain, it

was not a taxable item. It is not necessary that every addition or accretion to capital enter the corporate structure through the door of income.

That the petitioner was not dealing in its own stock and never intended to, is shown by the following:

(a) The stock was not carried as an investment like other securities, but was carried on the liability side as a deduction from issued capital.

(b) The fewness of the transactions detracts from the thought that the petitioner was dealing in its stock. Dealing in stock implies there is a dealer. But infrequent transactions are not sufficient to constitute one a dealer. *Pan-American Bank & Trust Company,* 5 B. T. A. 839. Said the Board (p. 845):

> "From the evidence we are of the opinion that the infrequent and isolated transactions in corporate and municipal bonds with the depositors of petitioner are not sufficient to constitute petitioner a dealer in securities."

(c) There was no profit motive behind the purchases and sales. The motive was to induce persons to become new subscribers.

POINT IV.

Assuming that the Petitioner Was Dealing in Its Own Stock, Contrary to Our Contention, Then Gain or Loss Arose in 1931 When the Petitioner Purchased Its Outstanding Stock.

The petitioner was formed on April 8, 1930, when the stock here in question was first sold. In 1931 the petitioner bought in some of its outstanding stock. Even if we assume that petitioner was dealing in its own stock, then in that year it had a gain or loss, depending upon the price at which the stock was sold in 1930. Assuming the 662 shares were sold at par, or $66,200 in 1930, then when the peti-

tioner bought in the stock for $64,648.40 in 1931 a profit of $1,551.60 was realized. This principle of taxation was announced by this Court in *United States* v. *Kirby Lumber Company*, 284 U. S. 1, involving a case where a corporation purchased its outstanding bonds. In that case the plaintiff had sold its bonds at par for $12,126,800. Later in the same year it purchased in the open market some of the same bonds at less than par, the difference in price being $137,521.30. The Supreme Court in holding that the plaintiff was taxable in buying in its outstanding bonds at less than the selling price said this (p. 3):

> "The defendant in error has realized within the year an accession to income if we take words in their plain popular meaning, as they should be taken here."

The case at bar is exactly the same in principle. If a corporation sells a share of stock for $100 and buys it back for $90, one cannot deny that the corporation has a $10 gain which it would not have had but for the transaction, "if we take words in their plain popular meaning." Applying the principles the Supreme Court laid down in the *Kirby Lumber* case, *supra*, to the present case, we have the petitioner $1,551.60 better off in 1931 than it was before.

But the Board says (R. 22-23) that while the *Kirby Lumber* case is applicable where a corporation buys in its own bonds, it does not apply where a corporation buys in its outstanding stock. It attempts to distinguish the situation by saying that in the case of bonds there is an outstanding liability but in the case of stock there is no obligation on the part of the corporation to pay the holder thereof a specified sum. Moreover, says the Board (R. 22), the value of a corporation's stock may fluctuate. Clearly these are distinctions without a difference. The principles of income taxation do not concern themselves with such refinement. They are predicated, says the Supreme Court in *Eisner* v. *Macomber*, 252 U. S. 189, 207, on—

> "'* * * the gain derived from capital, from labor, or from both combined,' * * *.

> "* * * *not* a gain *accruing to capital*, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being '*derived*,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property. * * *"

Applying the foregoing rule, it is clear that the petitioner, if it realized a gain in dealing in its stock, did so in 1931, when the profit to the extent of $1,551.60 was realized as outlined above.

If petitioner was dealing in its own stock, then when it sold 662 shares in 1933, that was the beginning of another transaction upon which gain or loss will occur, depending upon the price at which the stock is later acquired. In this connection it is to be noted that there must be two transactions before gain is realized or loss is sustained. The usual transaction begins with a purchase and ends with a sale. Frequently, as is the situation here, the events are reversed; such a reversal occurs in the case of a short sale, where the sale occurs before the purchase. The gain or loss does not arise when the sale occurs, but is postponed until the purchase is made.

In differentiating the case at bar from that of the *Kirby Lumber Company*, the Board stated (R. 22) that the value of a corporation's stock may fluctuate. In petitioner's view, such fact is immaterial in the situation here involved.

POINT V.

If Respondent's Contentions in the Court Below Were to be Adopted, Absurd Results Would Follow.

Just a few illustrations will show how absurd will be the results in cases arising under the rule contended for by the respondent in the court below.

1. Corporation A buys 662 of its shares at $100 a share. Thereafter the remaining stockholders make a contribution to capital of $100 a share so that the outstanding stock is now worth $200 a share. If the corporation now sells the 662 shares at $200 a share a profit of $66,200 results. What theory sustains such profit?

2. But suppose Corporation A instead of receiving a paid-in surplus of $100 a share makes a distribution of $50 a share. If the corporation now sells the 662 shares at $50 a share a loss of $33,100 results. (Clearly an artificial loss, yet it would be deductible under the respondent's view.)

3. Corporation A might have a double loss when only one loss occurs, or a double profit when only one profit occurs. Let us suppose Corporation A had $50,000 capital stock issued (worth par) and $50,000 capital stock in the treasury, for which it paid par. Now if it should have an operating loss of $25,000 and should then sell the treasury stock at its then present value of $25,000, a loss of $50,000 for the year would be the result ($25,000 operating loss and $25,000 stock loss).

4. On the other hand, if Corporation A had a $25,000 operating profit and sold the treasury stock for $75,000, the profit would be $50,000 for the year.

5. If Corporation A owns treasury stock costing more than the present fair market value of its outstanding stock it would be in a position to create a tax loss through selling its treasury stock, although such a loss would be most artificial. If Corporation A is in a position where it would have a gain should it sell its treasury stock, it could avoid the gain by the simple expedient of amending its charter and claiming the transaction to be a recapitalization.

Taking advantage of such loopholes as would exist above may not be very laudable, yet the Government ought to be the last one to dangle them before the very eyes of the taxpayers.

Conclusion.

WHEREFORE, it is respectfully submitted that the judgment of the Circuit Court of Appeals for the Third Circuit should be reversed.

JOHN E. MCCLURE,
920 Southern Building,
Washington, D. C.,
Counsel for Petitioner.

MAUDE ELLEN WHITE,
DAVID W. RICHMOND,
MILLER & CHEVALIER,
920 Southern Building,
Washington, D. C.,
Of Counsel.

November, 1938.